

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of        )  
  )  
LEONE AND ANITA CRESCENZI            )

For Appellant:     Adey May Dunnell, Attorney at Law

For Respondent:    Burl D. Lack, Chief Counsel;  
                      Wilbur F. Lavelle, Assistant Counsel

O P I N I O N

This appeal is made pursuant to Section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Leone and Anita Crescenzi to a proposed assessment of additional personal income tax in the amount of \$129.00 for the year 1956.

The question presented is whether Appellants may claim a bad debt deduction in the amount of \$6,450.00 for the year 1956.

On April 21, 1954, Appellants sold their partnership interest in the Wonder Social Club for \$6,900.00 to Otello Micheletti, taking his unsecured promissory note for the full purchase price. The note provided for monthly installment payments of \$150.00 plus 6 percent interest.

Although suffering from diabetes, Micheletti thereafter took part in the management of the partnership business to the extent his health permitted. He made payments of \$150.00 each on the first days of July, August and September, 1954. No other payments were ever made. Appellants did not begin collection proceedings immediately after default because they believed Micheletti had sufficient unliquidated assets to satisfy the debt.

On April 1, 1955, Micheletti sold the business interest he had acquired from Appellants. He assured them that he was seeking other employment and would pay the obligation after he found work. While Micheletti was in poor health during 1955 and periodically underwent treatment for diabetes, Appellants believed that such treatment was for the purpose of regulating his drug intake and diet so as to permit him to lead a normal life.

Early in 1956 Micheletti repeated his promise to pay the note but later in the year he informed Appellants that his doctor had advised him that his health was impaired to the extent that

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He would never be able to work. He also told them that he had depleted his assets. Appellants secured a credit report on the debtor but this proved to be inconclusive. On October 25, 1956, Micheletti executed an affidavit which stated that he was 59 years of age, that he was unemployable, that he had no assets, and that he would not be able to pay his obligation to Appellants. After seeking the advice of their accountant, Appellants deducted the sum of \$6,450.00 as a bad debt on their 1956 personal income tax return.

The Franchise Tax Board disallowed Appellants' deduction on the ground that the debt became worthless in the year 1955. Respondent contends that the sale of the debtor's business interest, which was his only known asset, was an identifiable event establishing the worthlessness of the debt.

Section 17207 of the Revenue and Taxation Code permits a deduction for "any debt which becomes worthless within the taxable year." It is well settled that this language requires the application of an objective test of actual worthlessness. The taxpayer has the burden of showing that some event occurred which actually rendered the debt worthless in the year for which he seeks the deduction. The date on which the fact of worthlessness is ascertained is immaterial. (Appeal of Isadore Teacher, Cal. St. Bd. of Equal., April 4, 1961, 3 CCH Cal. Tax Cas. Par. 201-735, 3 P-H State & Local Tax Serv. Cal. Par. 58187.)

The only question here is whether the obligation became worthless in 1955 or in the following year. It appears to be an accepted fact that the note did have value at the beginning of 1955 and became worthless some time prior to the end of 1956. Because of the various imponderables contained in the record before us, it is not possible to determine the precise date of worthlessness with any degree of nicety. We concur in the Respondent's contention that the evidence should be considered from a common sense, practical viewpoint. Viewed in this light, however, we are of the opinion the evidence preponderates in favor of Appellants.

We cannot agree that the sale of the business interest, even if it was Micheletti's only asset, established the worthlessness of his debt. There is no evidence that the sale was not bona fide or that Micheletti did not receive full value for his interest. The practical effect of an arm's-length sale is merely the substitution of one asset for another of equal value.

Respondent cites James F. Curtis, 39 B.T.A. 366, aff'd 110 F.2d 1014, for the proposition that disposal of the debtor's only known asset is an identifiable event establishing the worthlessness of a debt. The facts of that case are clearly distinguishable. There the debtor corporation sold its only asset, a parcel

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of land, for \$7,500.00; these proceeds were then paid to the creditor who applied them against a balance due of about \$190,000.00. The debtor was thus stripped of all assets save its corporate franchise. In contrast, Micheletti retained the proceeds of his sale. There is no evidence that the total of his assets was in any way reduced by the 1955 transaction. Since no other significant changes in his financial condition are shown to have occurred that year, there is no basis in the record for a finding that the debt became worthless in 1955.

The debtor repeatedly assured Appellants that he would repay them. Nothing in the record indicates that he could not have fulfilled his promise had his diabetic condition improved. Apparently Micheletti's health was gradually deteriorating. Some time in 1956 his doctor determined that he could not expect to work again. Confronted with the choice of determining whether the debt became worthless in 1955 or in 1956, we think that the more reasonable view is that it became worthless in 1956.

O R D E R

Pursuant to the views expressed in the Opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Leone and Anita Crescenzi to a proposed assessment of additional personal income tax in the amount of \$129.00 for the year 1956, be and the same is hereby reversed.

Done at Sacramento, California, this 17th day of May, 1962,  
by the State Board of Equalization.

Geo. R. Reilly, Chairman

John W. Lynch, Member

Paul R. Leake, Member

Richard Nevins, Member

                    , Member

ATTEST: Dixwell L. Pierce, Secretary